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April 21, 2011

## Bad Faith - Settlement - Reimbursement From Insured

*American Modern Home Insurance Company v. Sohail Fahmian*  
Court of Appeal, Fourth District (April 8, 2011)

This case considered whether an insurer defending a personal injury action pursuant to a reservation of rights may recover settlement payments made over the objections of its insured when it provides notice to the insured of the same and where it is later determined that there was no coverage for the claim.

Sohail Fahmian was sued for personal injuries by a worker on a residence Fahmian and his construction company were building. Fahmian tendered the matter to his homeowners carrier, American Modern Home Insurance Company ("American Modern"). American Modern accepted the defense pursuant to a reservation of rights. During the course of the litigation, the plaintiff Rudy Montoya made a \$300,000 policy limits demand to Fahmian.

On July 1, 2005, American Modern informed Fahmian in writing that it intended to settle the case for the policy limits, unless Fahmian chose to either undertake his own defense, or agreed to waive any potential claims based on the failure to settle the Montoya action within the policy limits. In this letter, American Modern also indicated that the plaintiff's settlement demand was set to expire on July 8, and that the carrier would need to know Fahmian's position by July 5. On July 5, Fahmian requested that American Modern's coverage counsel send him a copy of the letter by e-mail, so he could send it to his counsel. At the same time, the carrier's coverage counsel told Fahmian to let them know by July 8, the deadline on



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plaintiff's demand, what Fahmian wanted to do. By July 8, Fahmian had not responded, and the carrier entered into a settlement for its policy limits.

The carrier subsequently filed a declaratory relief action against Fahmian, seeking a determination that the claim was not covered and that the carrier was entitled to reimbursement of monies paid to settle the claim. The case proceeded to trial, and it was determined that as Fahmian was building the home for business purposes, there was no coverage for the claim. However, the trial court determined that American Modern was not entitled to reimbursement because Fahmian had not had sufficient time to respond to the carrier's offer that he assume his own defense if he objected to the settlement. American Modern appealed.

The Court of Appeal reversed. Both the trial court and the Court of Appeal referred to and relied upon the decision of the California Supreme Court in 2001 in *Blue Ridge Ins. Co. v. Jacobsen* (**WEEKLY LAW RESUME MAY 24, 2001**). *Blue Ridge* involved the same issues, and the Supreme Court there concluded that an insurer may obtain reimbursement for a reasonable settlement payment, made over the insured's objection, if it first offered the insureds a chance to assume their own defense. However, the trial court in this case determined that implicit in the *Blue Ridge* decision was a requirement that the carrier's notice to the insured of an attempt to settle must provide the insured with "sufficient time" to consider the offer.

The Court of Appeal noted that the pre-requisites for seeking reimbursement for non-covered claims included in a reasonable settlement payment were "(1) a timely and express reservation of rights; (2) an express notification to the insureds of the carrier's intent to accept a proposed settlement offer, and (3) an express offer to the insureds that they may assume their own defense when the carrier and insured disagree whether to accept the settlement offer." The Court of Appeal noted that the Supreme Court did not intend to include a requirement of "sufficient time" for the insured to consider the notice of intent to settle and offer to the insured to assume its own defense.

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The Court of Appeal noted that quite often a plaintiff's settlement offer may come at any time in a case, and will usually contain time limitations not in the control of the carrier or the insured. In addition, the requirement of a timely and express reservation of rights puts the insured on notice, such as Fahmian was here, that the carrier was reserving its rights to seek recovery should it be determined that there was no coverage. It would not be reasonable to allow the insured to derail the settlement process expressly allowed by the Supreme Court in *Blue Ridge* simply because it failed to obtain coverage counsel until a settlement offer was received.

The Court also noted that the time provided by the insurer in *Blue Ridge* to its insured when it gave notice of settlement was generally the same time limit provided by American Modern to Fahmian, and that the time given by the carrier in each instance was tied to the time limits of the plaintiff's settlement demand.

Finally, the Court noted that the *Blue Ridge* settlement process had two important purposes. First, it avoided unjust enrichment on the part of an insured that was not covered for the loss in the first place, and secondly, it encouraged the resolution of lawsuits by settlement, by encouraging carriers to defend and settle cases for which insurance coverage is uncertain, knowing that a vehicle exists for it to recover the settlement costs from its insured if it is proved correct on the issue of lack of coverage. This transfers the risk of an insured's inability to pay to the carrier, rather than to the injured party.

The Court of Appeal reversed the judgment and directed the trial court to enter judgment in favor of American Modern on the issues of coverage and its rights to reimbursement of settlement and defense costs.

## COMMENT

This case clarified the *Blue Ridge* process and that there is no time requirement for the carrier's offer to allow the insured to take over the defense as long as it has timely and expressly reserved its rights prior to the same.

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For a copy of the complete decision see:

[HTTP://WWW.COURTINFO.CA.GOV/OPINIONS/DOCUMENTS/G042799.PDF](http://www.courtinfo.ca.gov/opinions/documents/G042799.pdf)

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